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THE DEBATE OVER U.S. TRADE POLICY TOWARD JAPAN

Summary

Whether at the White House, on Capitol Hill or in corporate boardrooms, the mainstream trade prescription for lowering the huge bilateral imbalance is opening Japan's markets. The consensus ends there. President Bush and most of his economic advisers are convinced that market forces will do the job, with pressure required only as a backup. Many legislators and a growing number of business executives are equally convinced that this strategy, a carryover from the Reagan administration, is bankrupt. A more activist approach to dealing with Japan is required, they argue, one that is grounded in reality, not the textbook world of free trade.

While recommendations billed as new strategies for handling the "Japan trade problem" generally are lumped under the heading of managed trade, not all of them revolve around numerical targets for Japanese imports or for reductions in the bilateral trade gap. An approach that seems to have broad but largely implicit support in Congress and the business community certainly does not fit that narrow definition. Backers of this plan say the United States should piggyback on the growing movement for change in Japan, applying constant pressure on Tokyo to open markets, threatening retaliation against U.S.-bound Japanese exports if necessary and devising procedures to ensure compliance with market access arrangements already worked out. Negotiating market shares for internationally competitive American products is not ruled out in this approach but is regarded as a last resort.

By staking out a middle ground between free trade and managed trade, proponents of these tactics hope to move the White

House in the direction of a tougher policy on Japan. The Bush administration, however, shows no signs of budging from its current nonconfrontational Japan strategy. Moreover, the chances that legislation incorporating a more activist approach to dealing with Japan will be passed this year are rated slim despite the widespread congressional opinion that "something must be done." Neither are the odds good for significant action on what all sides agree is the fundamental cause of the stubborn U.S.-Japan trade imbalance -- the federal budget deficit.

Defining the "Japan Trade Problem"

After eight years of nonstop growth the U.S. trade deficit with Japan finally topped out at $56.3 billion in 1987 and then dropped to $49 billion last year (see Table 1). The roughly 50 percent slide in the value of the dollar against the yen between September 1985 and the end of 1988 and the shift to domestic demand-led growth in Japan helped both sides of the bilateral trade ledger. Japan-bound exports doubled in the second half of the 1980s, outperforming total U.S. sales abroad by a third. The expansion was broad-based, extending from industrial and agricultural inputs to capital and consumer goods (see Table 2), but manufactured products were the pacesetters by a significant margin. At the same time American purchases of Japanese products, while tracking almost exactly the 37 percent increase in aggregate imports over the 1985-89 period, lagged the rise in the total from 1987 on.

The realignment of the yen-dollar exchange rate and buoyant demand at home from consumers and producers alike also reversed the steadily upward course of Japan's trade surplus, both overall and with the United States. While the reduction in the bilateral gap from its 1987 peak was the result of slower-growing exports and faster-rising imports, the cut in Japan's total figure from a record $82.7 billion in 1986 to $64.3 billion last year was the exclusive work of higher purchases from overseas, particularly of manufactured goods. Counting from 1985, imports of manufactures soared 164.2 percent in dollar terms -- an advance that translated into a 51.4 percent yen-denominated climb and more than a twofold gain on a volume or price-adjusted basis. In the process the closely watched relationship between manufactures and total imports changed from 31 percent in 1985 to 50.3 percent last year (see Tables 3-5).

To many American observers these often-cited numbers convey a deceptive picture of progress on the bilateral and the Japanese trade fronts. They acknowledge that macroeconomic policy changes, exchange rate shifts and the removal of most of Japan's formal import barriers are moving trade flows in the right directions, opening markets in Japan and curbing the expansion of Japanese exports. Their quarrel is with the long list of trade statistics skipped in the usual government presentation. These indicators, it is argued, all point to an unaddressed Japan trade problem, particularly on the import side. Some examples:

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Table 1: U.S. Trade, 1980 and 1985-89

(in millions of dollars; exports f.a.s., imports Customs)

	Exports	Percent Change	Imports	Percent Change	Trade Balance
			Total Trade		
1980	$225,722	21.0%	$245,262	16.6%	$-19,540
1985	218,828	-2.3	345,276	6.0	-126,448
1986	227,159	3.8	369,961	7.1	-142,803
1987	254,122	11.9	406,241	9.8	-152,119
1988	322,426	26.9	440,952	8.5	-118,526
1989*	364,350	13.0	472,926	7.3	-108,576
			Trade with Japan		
1980	20,790	18.3	30,867	17.6	-10,077
1985	22,631	-4.0	68,783	20.4	-46,152
1986	26,882	18.8	81,911	19.1	-55,030
1987	28,249	5.1	84,575	3.3	-56,326
1988	37,725	33.5	89,519	5.8	-51,794
1989*	44,584	18.2	93,586	4.5	-49,002
			Trade with European Community		
1980	58,855	n.a.	38,211	n.a.	20,644
1985	48,994	-3.0	67,822	12.6	-18,828
1986	53,154	8.5	75,736	11.7	-22,582
1987	60,575	14.0	81,188	7.2	-20,613
1988	75,755	25.1	84,939	4.6	-9,183
1989*	86,592	14.3	85,129	0.2	1,463
			Trade with Canada		
1980	40,331	n.a.	41,025	8.2	-694
1985	53,287	2.9	69,006	3.8	-15,719
1986	55,512	4.2	68,253	-1.1	-12,741
1987	59,814	7.7	71,085	4.1	-11,271
1988	71,622	19.7	81,398	14.5	-9,776
1989*	78,588	9.7	88,210	8.4	-9,622
			Trade with Hong Kong, South Korea, Singapore and Taiwan		
1980	14,741	24.1	17,779	11.5	-3,038
1985	16,918	-4.5	39,066	7.4	-22,148
1986	18,290	8.1	46,136	18.1	-27,846
1987	23,547	28.7	57,664	25.0	-34,117
1988	34,816	47.9	63,030	9.3	-28,214
1989*	38,458	10.5	62,756	-0.4	-24,298

*Preliminary

Source: Department of Commerce

Table 2: U.S. Trade with Japan by End-Use Category, 1980 and 1985-89

(in millions of dollars; exports f.a.s., imports Customs*)

	1980	1985	1986	1987	1988	1989
Total Exports	$20,790	$22,631	$26,882	$28,249	$37,725	$44,584
Food, Feed and Beverages	5,393	5,001	5,043	5,555	7,892	8,443
Industrial Supplies	9,501	8,680	8,752	10,156	12,989	15,372
Capital Goods	4,148	5,694	6,428	7,388	9,874	11,331
Automotive Products	192	245	300	382	754	1,034
Consumer Goods	1,154	1,416	1,690	2,551	3,564	4,987
Other Exports	403	1,596	4,670	2,218	2,652	3,418
Total Imports	30,701	68,783	81,911	84,575	89,519	93,586
Food, Feed and Beverages	297	500	504	451	394	344
Industrial Supplies	5,926	7,035	6,949	7,281	8,471	8,464
Capital Goods	6,555	21,516	25,334	28,947	33,853	37,015
Automotive Products	11,436	24,980	32,849	33,695	31,978	33,734
Consumer Goods	6,198	14,017	15,451	13,385	14,083	12,961
Other Imports	289	734	824	817	740	1,068

*1980 imports are valued f.a.s.

Note: The figures for 1988 and 1989 are not strictly comparable to the numbers for earlier years because of minor changes in the end-use classification.

Source: Department of Commerce

• From a peak of $152.1 billion in 1987 the U.S. trade deficit with the world contracted to $108.6 billion in 1989 -- a 28.6 percent shrinkage. Over this period the shortfall in trade with Canada, which had been dropping since 1985, declined 14.6 percent, the deficit with the European Community was replaced by a small surplus and the import-export gap with Asia's newly industrialized countries (Hong Kong, South Korea, Singapore and Taiwan) narrowed 28.8 percent. The U.S. deficit with Japan, however, declined just 13 percent. Moreover, last year's bilateral imbalance still was above the 1985 level. To make matters worse, trade with Japan represented only 16.5 percent of combined U.S. exports and imports in 1989 but 45.1 percent of the overall deficit.

• Although American shipments of manufactured products to Japan soared 118.6 percent between 1985 and last year to $27 billion, bumping the manufactured ratio to 60.5 percent, this number did not measure up to the comparable figures for the European Community (80 percent-plus), Canada (just over 90 percent) or even the Asian NICs (mid-70s). Likewise, Japan-bound high technology exports, while on the upswing in the second half of the 1980s, made up a smaller portion of sales -- roughly 30 percent -- than the equivalent statistic for the European Community -- about 45 percent. In addition, this country consistently ran a big deficit in high technology trade with Japan but sold substantially more of these products to the European Community than it bought.

Table 3: Japan's Imports of Manufactured Products, 1980 and 1985-89

(in millions of dollars/billions of yen; c.i.f. value)

	Dollar Terms		Yen Terms		Share
	Total	Percent Change	Total	Percent Change	of Total Imports
1980	$32,110	6.2%	Y7,304	16.5%	22.8%
1985	40,157	-1.1	9,636	0.2	31.0
1986	52,781	31.4	8,896	-7.7	41.8
1987	65,961	25.0	9,575	7.6	44.1
1988	91,838	39.2	11,770	22.9	49.0
1989	106,111	15.5	14,588	23.9	50.3

Source: Japan Tariff Association

Table 4: Japan's Imports of Manufactured Products by Major Supplier, 1985-89

(in millions of dollars; c.i.f. value)

	Total		United States		European Community		Asian NICs*	
	Amount	Percent Change	Amount	Percent Change	Amount	Percent Change	Amount	Percent Change
1985	$40,157	-1.1%	$14,2436	1.9%	$7,691	-5.8%	$5,689	-0.8%
1986	52,781	31.4	17,645	23.9	11,956	55.4	7,803	37.2
1987	65,961	25.0	17,672	0.2	15,146	26.7	12,459	59.7
1988	91,838	39.2	23,540	33.2	20,770	37.1	18,234	46.4
1989	106,111	15.5	28,119	19.5	24,193	16.5	20,495	12.4

*Hong Kong, South Korea, Singapore and Taiwan.

Source: Ministry of Finance

• Despite the rapid expansion of foreign purchases by Japan, manufactured imports do not play as big a role in the economy as they do in its two major industrial rivals. Manufactures represented 80 percent of total imports in the United States in 1989 and an estimated 75 percent in West Germany compared to Japan's 50.3 percent figure. Moreover, while the ratio of total imports to gross national product is far lower in both Japan and the United States (7.4 percent and 9 percent, respectively, last year) than in West Germany (22.4 percent), Japan becomes the odd man out when the measure is purchases of manufactured products from abroad. At 3.7 percent in 1989, its imported manufactures-to-GNP ratio was considerably below the 9 percent U.S. statistic and especially the West German figure of 15.6 percent (1988). Similarly, in 1988 Japan imported only $749 worth of manufactures per person versus $1,468 for this country and $3,075 for West Germany, the Department of Commerce calculated, even though all three had roughly equivalent per capita GNPs.

For numerous trade watchers these and similar statistics add up to just one conclusion: Japan's imports of manufactures, whether from the United States

Table 5: Japan's Imports of Capital amd Consumer Goods by Major Supplier, 1980 and 1985-89

(in millions of dollars; c.i.f. value)

	1980	1985	1986	1987	1988	1989
Capital Goods	$9,096	$11,541	$13,229	$16,328	$22,341	$26,637
United States	4,888	7,504	7,785	9,025	12,250	14,434
European Community	2,247	1,845	2,763	3,606	4,513	5,107
Southeast Asia	790	1,179	1,473	2,313	3,662	4,926
Consumer Nondurables	2,677	3,319	4,711	7,718	10,706	13,603
United States	322	314	403	857	1,200	1,531
European Community	697	692	1,008	1,400	1,928	2,741
Southeast Asia	1,167	1,574	2,368	4,093	5,548	6,417
Consumer Durables	2,395	2,974	4,601	7,977	11,938	15,431
United States	561	590	740	1,086	1,711	2,326
European Community	855	1,105	1,949	3,575	5,322	7,176
Southeast Asia	672	873	1,393	2,538	3,809	4,241

Source: Japan Tariff Association

or elsewhere, are substantially less than would be expected for a country of its economic standing. That finding holds, they note, even when allowance is made for Japan's resource endowment, geographic location and other economic factors (see JEI Report No. 14A, April 8, 1988). In this view trade barriers, now mostly informal, are the major explanation for Japan's subpar import performance.

A Look Back

The belief that trade with Japan presents unique problems is hardly new. Nor are the accompanying calls for a tailor-made Japan strategy. The same conviction shaped a number of Japan-specific or Japan-motivated market access resolutions and bills in the mid-1980s as the U.S. trade deficit, fueled solely -- or so it was portrayed -- by a flood of red ink in the bilateral account, started rocketing out of control. Legislators on both sides of the aisle constantly railed against the Reagan administration's management of trade issues with Japan. They claimed that the White House's generally hands-off approach to the unfair trade practices allegedly behind the soaring U.S.-Japan imbalance (and, by extension, the overall deficit) amounted to no policy at all. By default, therefore, Congress had to take up the cause of American trade interests at home and in Japan.

Reagan administration trade officials bristled at the charge that they had no policy for dealing with Japan on market access issues, but they were hard-pressed to defend their negotiating record. The strategy of trying to gain improved access by targeting one specific problem area -- beef and orange quotas, for example -- and then moving on to another one product-one issue area had netted only piecemeal results after usually protracted bargaining. This scorecard, it was concluded, would not douse the protectionist fires on Capitol Hill; an entirely different approach was needed.

The White House's answer was in-depth sectoral negotiations to improve Japanese market opportunities for highly competitive American exports. Previewed during 1984 financial liberalization talks, this negotiating tactic came into its own at the beginning of 1985 with the launch of the awkwardly named market-oriented, sector-selective discussions. The idea behind the MOSS format was deceptively simple: pick a handful of product areas where Japanese restrictions prevented U.S. manufacturers from fully exploiting their technological or pricing edge and then tackle the full range of barriers that could impede access.

Selected for initial treatment were four product groups that had been the subject of previous market access negotiations -- telecommunications equipment and services, medical equipment and pharmaceuticals, sophisticated electronics, and forest products. Automotive products were added in 1986. No deadline was set for the talks, although it was clear to trade officials in both countries that steady progress had to be made if the discussions were to have any impact on Capitol Hill's get-tough-on-Japan mood. Neither did the administration establish dollar targets for export increases to measure the success of the negotiations, a decision that followed considerable internal debate.

Despite negotiating gains, the MOSS talks failed to convince congressional trade hawks that the White House had a trade strategy, either for Japan or for the generic problems hamstringing U.S. exporters. By late summer 1985 passage of at least one import-restrictive piece of legislation and possibly a few others seemed a safe bet. These odds finally forced the administration to go on the offensive. In a major trade policy initiative announced in September, President Reagan unveiled a strategy of "free and fair trade," featuring a program to combat unfair foreign trade practices and a commitment to take the lead in the movement toward a new round of multilateral trade negotiations under the General Agreement on Tariffs and Trade. Foreign trade practices that damage American interests no longer will be tolerated, the chief executive said in a speech directed equally at congressional critics of his trade policy and at Japan and other U.S. trading partners. He spelled out a plan to enforce trade statutes more aggressively and to set up an interagency "strike force" to pinpoint unfair trade practices and develop ways to eliminate them.

The White House actually had previewed its new harder line on unfair foreign trade practices earlier in the month when it took the unprecedented step of self-initiating three investigations under Section 301 of the 1974 Trade Act, including one against Japan's restrictions on sales of foreign cigarettes. At the same time the president gave Tokyo less than three months to resolve a long-running dispute over import quotas on leather and leather footwear, another step never before taken by Washington. Then in December 1985 Mr. Reagan, endorsing the first recommendation of his trade strike force, gave the Commerce Department the green light to start an antidumping investigation of memory chips imported from Japan, another precedent-setting action.

These demonstrations of a White House on the move against Japan and other major U.S. trading partners, including the European Community, persuaded many initially skeptical legislators that the administration in fact had a substantive trade policy. More than anything, though, the five-nation agreement orchestrated by the United States to lower the dollar's sky-high value -- reached the day before Mr. Reagan unveiled the new U.S. trade strategy -- alleviated congressional frustration over the handling of trade issues. This pact

marked a significant policy shift for the administration, which previously had viewed the strong dollar as a reflection of U.S. economic strength rather than as a primary cause of the surging bilateral and overall trade deficits.

Having switched trade and exchange-rate policy gears, administration economic officials basically sat back and waited for the falling dollar to correct the towering trade imbalance. That was a tactical mistake. Influential lawmakers soon started to wonder aloud whether they could count on the White House to continue the crackdown on unfair trade practices in Japan and elsewhere. This questioning plus the initially perverse effects of the dollar's drop on the U.S. trade account supplied new momentum in 1986 to the drive for trade legislation. By then, however, the attraction of country- and product-specific protectionist measures had faded, replaced by a growing consensus on Capitol Hill that general trade reform represented a more constructive response to this country's multiplying trade problems.

In drafting language that would force the White House's hand on unfair foreign trade practices, congressional leaders were swayed by the checkered results of the MOSS talks and other administration efforts to open markets in Japan. Along with an increasing number of American businessmen, many representatives and senators had come to the conclusion that negotiating the removal of import barriers in Japan was a never-ending process; the elimination of one obstacle to sales just revealed another. They also were convinced that Washington allowed market access negotiations with Tokyo to drag on and often settled for a Japanese response short of the administration's initial goal. The reluctance of the White House to retaliate against Japan for allegedly inadequate compliance with market-opening agreements irked these critics as well. Moreover, they faulted U.S. trade policymakers for failing to target what appeared to be obvious roadblocks to American exports, including such informal barriers as Japan's distribution system and its buy-national psychology. But perhaps most troubling to frustrated legislators and business executives was the administration's reactive, ad hoc policy on Japanese market access issues.

These complaints found several forms of legislative expression in the three years it took an omnibus trade bill to get through both houses of Congress. The most publicized outlet was an amendment to the 1986 House bill by Richard Gephardt (D, Mo.). A watered-down version of a plan he and other Democrats had sponsored in 1985, the measure required the president to negotiate agreements with Japan and other countries running big trade surpluses with the United States and the world, aiming for 10 percent annual reductions in their bilateral surpluses. Failure to achieve these cutbacks would force the White House to act to bring down recalcitrant countries' imbalances. If the surpluses still did not drop, the president would have to impose import quotas to achieve the surplus-reduction goals.

Although extreme, the Gephardt amendment was indicative of the House's get-tough stand on closed foreign markets. A revamped, slightly less protectionist variant of this measure surfaced in the 1987 House-passed trade bill, but it had no counterpart in the Senate's version. Considered certain veto bait, the Gephardt amendment was dropped in the spring of 1988 by the House-Senate conference on HR 3. But Democrats and Republicans trying to force White House action on Japanese import barriers did not come up empty-handed. The so-called Super 301 provision of the 1988 Omnibus Trade and Competitiveness Act, signed into law that August, implicitly was crafted to open markets in Japan.

Round Two

Lawmakers soon discovered that they could tailor a Japan trade strategy for the executive branch but could not keep the White House from making alterations on its own. A deeply divided Bush administration named Japan a priority country under the Super 301 framework in May 1989, but instead of targeting a broad range of problem practices and products for negotiation and possible retaliation if bargaining failed to produce results over 12 months, the president's top advisers compromised. Chosen for Super 301 coverage were the three issues with the best prospects for successful negotiations -- exclusionary government procurement of supercomputers and satellites and a variety of restrictions on wood products. Aware that this limited move would not play well with Capitol Hill or Japan hard-liners in his cabinet, Mr. Bush also endorsed bilateral talks outside the Super 301 format on government and corporate policies and practices that impede access to Japanese markets.

The White House recognized that the Structural Impediments Initiative was a risky strategy for dealing with market access problems in Japan. The most Washington could achieve during the year-long process would be specific commitments from Tokyo for reforms in the six targeted problem areas and some first steps toward change. Full implementation of promised reforms would require time; even then it might take up to five years for any results of the SII discussions to show up in the U.S. export figures. Whether a Congress interested in quick fixes for the still huge bilateral trade deficit would wait that long was an open question.

Despite reservations legislators influential on trade matters were willing to give the administration at least some time to demonstrate that its market-opening approach would work. A number of people in the private sector, however, already had written off any attempt to negotiate an end to generic or systemic obstacles to imports, whether as part of the retaliatory Super 301 process or outside it. Their reasoning, in very simplified terms, is that it is unrealistic to expect meaningful concessions from Tokyo on what Washington labels structural or invisible barriers since these government and business policies and practices are keys to Japan's international economic strength. Rather than constantly straining the vital U.S.-Japan economic and political relationships by trying to negotiate the impossible, say some leading proponents of this revisionist line, the United States should establish quantitative import goals for Japan or numerical targets for the bilateral trade imbalance. In one version of Gephardt revisited Japanese imports of American manufactures would have to expand 15 percent a year in real terms or Washington would retaliate.

Managed trade proposals like this one have been condemned on almost all fronts. Economists argue that this strategy would reinforce aspects of how Japan conducts business that already are of concern to the United States. The Ministry of International Trade and Industry would have to organize numerous purchasing cartels and track closely their orders. Companies would be forced to collude to decide which one would buy what and how the imports would be sold. There also is the question of how American suppliers would divvy up the orders. In short, bureaucratic actions would replace market forces, just as they have with the restraint arrangements covering various U.S.-bound Japanese exports.

The broadbrush managed trade approach of the revisionist camp also is anathema to corporate America, but in recommending a new Japan trade strategy

to the Bush administration soon after it took office, top executives from several dozen of this country's big multinationals edged in that direction. The main requirement for the United States, the Advisory Committee for Trade Policy and Negotiations stated, is a cut in the federal budget deficit; without that step and expansionary macroeconomic policies in Japan, any attempt to rectify the bilateral imbalance will be doomed. Then, on the trade side, Washington needs what the group called a results-oriented policy.

Its proposal for tackling formal Japanese barriers to imports was patterned after the much-maligned MOSS format: identify those product areas where American suppliers are internationally competitive but unable to break into the Japanese market; establish sectoral negotiating priorities; define specific goals for "successful outcomes;" and, finally, negotiate the elimination of the restrictive measures. For informal or invisible barriers, however, ACTPN advocated sectoral import targets. In both cases Washington should devise procedures to monitor implementation and react decisively if Japan does not keep its commitments, either by filing a GATT complaint, self-initiating a regular Section 301 investigation or retaliating.

Viewed as a beefed-up Super 301, the advisory group's results-oriented Japan strategy has considerable backing on Capitol Hill. Whether this support can be translated into action is another matter. Despite some tough talk on Capitol Hill right before and immediately after the White House's late April decision to drop Japan from the Super 301 list (see JEI Report No. 18B, May 4, 1990), analysts say a full congressional calendar in this year's elections-shortened session makes passage of a Japan-targeted bill unlikely.

Next year could be a different story. The market-opening arrangements worked out this spring for supercomputers, satellites and wood products and Tokyo's early April plan for dismantling structural barriers to trade will have a marginal impact at best on American exports, which must expand more than twice as fast as imports of Japanese-made products just to keep the U.S.-Japan trade deficit at 1989's politically explosive $49 billion level. With the dollar strengthening against the yen over the past 17 months and some signs of softer domestic demand in Japan, the bilateral trade imbalance could widen again in 1991. That could provide the necessary momentum on Capitol Hill for a get-tough-on-Japan bill.

For further information, contact Susan MacKnight.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.